UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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ROBERT LOWINGER,

Plaintiff,

v. 13 CV 4016 (RWS)

MORGAN STANLEY & CO. LLC, et als.,

Defendants.

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New York, N.Y.
April 9, 2014
1:20 p.m.

Before:

HON. ROBERT W. SWEET,

District Judge

APPEARANCES

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Attorneys for Plaintiff
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(In open court)

(Case called)

MR. ROUHANDEH: Thank you, your Honor. Jim Rouhandeh from Davis Polk & Wardwell for the Morgan Stanley, JPMorgan and Goldman Sachs defendants.

This is an action under 16(b) brought by Mr. Lowinger against the three lead underwriters of the Facebook IPO. It's a very straightforward case. There's motions are made. There are three simple questions.

The first is: Did the underwriters and the selling shareholders form a group under 16(b)?

And the second is: Can plaintiff vitiate the exemption under 16(b) for good faith underwritings?

And the third is: Are the allegations relating to Goldman Sachs, do they suggest anything that they earned any profit and therefore should be somehow treated-- whether those allegations are any different than the allegations made against the other underwriters?

On the first issue, the plaintiffs failed to plead the existence of a group. What they do is-- well, first, the relevant statute says that -- and 16(b) borrows here from 13(d). They say a group is formed -- the statute and the rules say a group is formed where there is an "an agreement to act together for the purpose of acquiring holding, voting, or disposing of securities."

The plaintiffs here are saying there was such an agreement, and they point to lockup agreements entered into by the selling shareholders. The underwriters were not parties to those agreements, to those lockup agreements. They impose no obligations whatsoever on the underwriters. They were solely obligations on the selling shareholders.

And the first point here is that plaintiffs can't cite to a case at all, any case that has ever found that the underwriters are part of a group as a result of a lockup agreement executed by selling shareholders. The courts that have looked at that issue have always required something more, some additional supporting allegations. There are none here.

The second issue is that the language here, that "an agreement to act together for purpose of acquiring, holding, voting or disposing of securities," is not disjunctive. Well, it's a disjunctive in the sense that it can be acquiring, holding, voting or disclosing, but it's not otherwise disjunctive.

The agreement to act together and the common purpose and the either buying, selling, holding or voting have to all come together. You can't do what the plaintiffs -- and the CSX case on the Second Circuit has made that clear. You can't do what the plaintiffs are doing here, which is to say, oh, we have an agreement. There's a lockup agreement. Over here there's a purpose to do an IPO transaction. And over here

there were some-- an agreement to hold securities which the selling shareholders did.

That-- and that's what they're trying to do here. The definition of a group is borrowed again, as I said, from 13(d) in the Williams Act, which is -- you know, if you look at the purpose behind that, it was so that people couldn't get together, act together, and just not hit the 5 percent threshold and have an agreement to all vote in favor of a transaction or all sell at a certain time.

That's really what it was intended to do. Applied to this case, that's not at all what was going on here. All you had is a lockup agreement, again pursuant to what selling shareholders said. We'll limit the number of shares that we will sell 91, 181 and 211 days after the date of the prospectus.

So here, in fact, the plaintiffs have really sort of pled themselves out of court. Because what they plead is that the selling shareholders agreed to hold their stock, but not the underwriters. In fact, they allege that the lead underwriters bought shares in the aftermarket to cover the overallotment in connection with the overallotment option.

So they're saying on the one hand the selling shareholders are holding; on the other hand the underwriters are free to buy, sell, or do whatever they want with Facebook stock during that same lockup period.

In fact, they allege again-- the first set of allegations were paragraph 241 and 42 relating to the underwriters buying shares in the aftermarket to cover overallotment short sales. They also allege specifically as to Goldman Sachs that Goldman Sachs bought and sold Facebook stock during the lockup period. That's complaint paragraphs 43 through 45. So those transactions are fundamentally inconsistent with the underwriters agreeing with the selling shareholders to hold Facebook stock.

You've got on one hand some members of the group holding securities; on the other hand, you've got other members of the alleged group freely buying and selling subject to no agreement. That obviously cannot satisfy the statutory definition of a group. And, in fact, what it would do otherwise is essentially subject every ordinary course underwriting to 16(b).

Even apart from that issue and even if there were a satisfactory basis in the complaint or in the law to establish that there is a group here, or to plead that there is a group, the underwriters, the claim against the underwriters still fails because 16(a)(7) creates an exemption for good faith underwritings. And all that's really required is a bona fide distribution of securities.

This is -- what plaintiffs are trying to do is to say -- is to sort of give the Court a disclosure obligation

into 16(b) by saying, well, it's not a good-faith underwriting if we can allege that there was a nondisclosure or a misrepresentation in connection with the offering.

Now, obviously what that would do would be to bleed in all of the disclosure obligations of the securities laws into 16(b), which is a strict liability statute, which isn't supposed to-- it's not a disclosure statute at all. And it would render-- within this very narrow and very -- set of rules that are provided pursuant to it and it would just completely expand those by saying, well, the exemption for underwritings doesn't really apply unless-- because we can allege a misrepresentation. Once we do that, all underwritings are going to come with a 16(b) claim.

And it would-- so what the plaintiffs do is they sort of are hunting around for something to suggest that this wasn't a good-faith underwriting. They allege misrepresentations. They also look to the good-faith dealing under contract law and try to borrow that standard of what good faith means. It says -- it means honesty and decency and, therefore, we can allege bad faith or not a good-faith underwriting if we can say somehow this wasn't an honest or decent.

Again, that really is contrary to the whole intent behind 16(b) to turn it into a disclosure statute. In effect, it's inconsistent with the exemption to assert that any underwriting in which you could allege that there was a

misrepresentation makes it not a bona fide underwriting.

Then the third point is very simple. All the counts fail against all three of the lead underwriters. But, in addition, the plaintiffs seem to say, well, Goldman Sachs has-- we have some allegation that Goldman Sachs individually, we can point to their having earned a profit in the period after the prospectus.

But they have submitted-- first of all, there's no different additional argument as to Goldman. The argument is that Goldman, along with the other lead underwriters, formed a group with selling shareholders. They try, however, to suggest in their brief that Goldman was a 10 percent shareholder and they attach a Form 4 filed by Goldman Sachs that is Exhibit D to the Abraham declaration which makes clear that Goldman Sachs checks the box saying they're not subject to the rule, they're not a 10 percent shareholder.

So on its face that certainly doesn't support the suggestion that Goldman Sachs was ever-- was a 10 percent shareholder or an insider on its own. And that's really what they're trying to do. They're trying to say Goldman alone might have potential 16(b) liability, but they've pled themselves out of court on that one.

The other fundamental problem that they have is they speculate that Goldman Sachs made a profit. What they do is they say Goldman Sachs brought nine and a half million shares

in May 2012, after the IPO, and then they say they sold 5.6 million shares between July 1 and September 30th, 2012.

Now, the problem with that is -- in essence what they're saying is you sold at a higher-- we think you sold at a higher price in the third quarter of 2012 than you bought in May 2012. But they admit that they have no basis; that the prices that Goldman Sachs sold at are unknowable to them. They say that in paragraph-- page 33 of their brief. They're just speculating that Goldman sold at a higher price.

Now, maybe you could make that a reasonable inference if all of the trading prices in the period from July 1 to September 30th were higher than any of the trading prices in May of 2012, but that's not the case. And they plead themselves that there's an overlap.

So it's perfectly possible that Goldman Sachs bought at prices that were higher in May 2012 and sold at prices that were lower in the third quarter of 2012. And it wouldn't be inappropriate to really infer that they made a profit at all with respect to those purchases and sales given that the plaintiffs are saying, well, we don't know. All we know is there's some trading prices. There's an overlap, and an overlap in terms of those trading prices. They might have in effect sold at a higher price; they might have in effect sold later at a lower price.

And that is the state of their allegations. And they,

in fact, admit that they cannot-- that the prices are unknowable to them. Based on that I would submit they can't go forward with any separate theory or independent theory as to Goldman Sachs.

Those are the three points I wanted to hit. I would like to save a few minutes in rebuttal.

THE COURT: Sure.

MR. ROUHANDEH: Thank you.

MR. ABRAHAM: Thank you, your Honor. Jeffrey Abraham for plaintiff. Let me start with the last point counsel raised.

I'm looking at the Form 4 of Goldman Sachs and they check the box "10 percent beneficial owner." So I believe they would concede, or at least it's enough for a pleading standard, to establish they were a 10 percent beneficial owner since they checked that box under Form 4.

As to the particularity of the trades, we've alleged enough information to make it plausible that Goldman Sachs earned a short-swing profit. We rely on Judge Chesler's recent decision in *Claiborne*, which is cited in our brief, and which defendants ignore in their reply. And we go through the analysis in our brief of why it's plausible based upon changes in trading price, in Facebook stock, in Goldman Sachs' trading history based upon the Form 13F's that they filed with the SEC.

But let me move now to the first argument that my

opposing counsel made with respect to the issue of group. Did they form a group? Yes. Does everybody in the group have to do the exact same thing? No. There are cases, it's a case, *New Valley* case I believe that was decided by Judge Haight, that says that the members of the group do not have to march in lockstep. Here there was a clear objective to the group. It was that at least one selling shareholder owning more than 10 percent of Facebook stock would hold that stock.

Now, my opposing counsel also said the underwriters were not a party to that agreement. I disagree. The underwriters were parties to the lockup agreement. The selling shareholders entered into the lockup agreement with that selling shareholders. They were directly parties and they had common objectives. They needed the lockup agreement in order to have an IPO.

In fact, the lockup agreement at page B3 says the purpose is to facilitate the sale of Facebook stock in the IPO. The defendants in their brief, their opening briefs, say it was necessary to prevent the downward price pressure of additional stock sales. And the underwriters go on to say that the underwriters and the selling shareholders were each separately interested in ensuring a successful underwriting. And that's in defendants' opening brief at page 18.

Now, while it might be correct that there are no decisions directly on point holding that an underwriter is a

member of a group, we're not aware of any contrary decision either. And this is not the sort of case that comes up every day of the week.

We do point to the SEC amicus brief filed in *Morales V. Quintel Entertainment*, which says a group can be formed if one of the purpose is to keep stock off the market.

And Judge Marrero in *Schaffer v. CC Investments*, which we cite in our brief and defendants seem to ignore in their reply brief, says that *Quintel* indicates that a lockup provision may evince an agreement, but the Second Circuit declined to express a per say rule requiring such an inference. But, in other words, it is enough for a pleading motion to have that lockup agreement.

And the cases that the defendants cite to the contrary, quite frankly, are distinguishable. And for the sake of the lovely lady, I won't distinguish them here again. They are distinguished in our brief.

And in addition to-- also in the *New Valley* case, Judge Haight held that even if the group members had widely divergent interests, so long as they combine together for a common objective of holding the stock, they were properly considered members of the single section 13(d) group.

Now, moving onto the subject of the 16(a)(7) safe harbor, it's obviously dependent upon the good-faith conduct of defendants in performing the Facebook underwriting. There's

more than nondisclosure here. The defendants' conduct in selling Facebook stock while in possession of inside information, and then buying it back at a lower price, is a nondisclosure violation in and of itself. It's an insider trading violation of its own.

I want to emphasize that Facebook is not your everyday IPO. The size and price of this IPO were increased in the face of adverse information about the company's operating results, which the underwriters knew, but was not disclosed at large to the investing public, but instead was selectively disclosed to certain investors. An unusually large proportion of the offering was sold to retail investors. An unusually large proportion of the offering was shorted approximately 25 percent.

Now, with respect to the underwriter overallotment, they sold shares short against the overallotment. And the purpose of the overallotment is that the underwriters are going to buy back at the IPO price to prevent the stock from declining below the IPO price, which we would refer to, I think is popularly referred to, as stabilization.

But here they didn't do that. They sold short of 38 when they didn't disclose key information, material information. When the material information came out, they didn't stabilize at 38. They took advantage of that information. They bought back below 38. And, according to

published reports, beyond the underwriting commission, they earned an additional $100 million on this short-swing trading.

This is not an ordinary IPO and the conduct here, certainly on a motion to dismiss, is not good faith. And it would be defendants' burden to demonstrate, since Rule 16(a)(7) is an affirmative defense, that they have, in fact, acted in good faith. And they haven't done that.

And with respect to the specific shares that they made the real profit on, they did not act as conduit for the selling shareholders or the issuer. They acted on their own. They sold shares. They didn't buy them back on the overallotment option. They bought them back in the open market at a substantially lower price and they earned an unusually large profit in the IPO, your Honor.

Does your Honor have any questions?

THE COURT: Thank you.

MR. ROUHANDEH: Thank you, your Honor. Just a few quick points. First as to Goldman Sachs, taking them in the order that Mr. Abraham addressed them. Goldman Sachs was made a 10 percent shareholder by checking the box. Your Honor can review it, obviously. It's Exhibit D to Mr. Abraham's declaration. There's a box which Goldman Sachs checks and it says "Check this box if no longer subject to Section 16."

And, in fact, they couldn't possibly be subject to

Section 16 on their own because, as your Honor will see in explanation of response to number 4, it says following the sale as of the date of this filing, which was May 17th, following such sale, GS Group beneficially owns 8.9 million shares of common stock. We know that there were 421 million shares, not including the overallotment, in connection with the IPO. It's obviously not anywhere near 10 percent. They were not a 10 percent shareholder.

The second issue, the common objectives point, Mr. Abraham said that, in essence, that it was sufficient to have a common objective to really do the IPO and do the things necessary to carry out an IPO. But the point of the provision and the actual language of the statute says a common objective-- "an agreement to act together for the common purpose of buying, selling, holding or voting."

And, in fact, the case that I believe was the *Schaffer* case, that Mr. Abraham read from, he quoted language that referred to a common objective to hold stock. That's the type of common objective, not simply any common objective in connection with an IPO transaction. I'm sure he could define many common objectives that were pursued in connection with any IPO, and certainly this one.

He also said that-- Mr. Abraham said that the parties don't have to agree to act together, don't have to do the same thing, in essence. Well, that's not correct. The language of

the rule requires acting to get-- agreeing to act together for the common purpose of holding, and you don't have that here.

Finally, the *Quintel* case that he mentioned, apparently in response to my argument, that there's no case holding an underwriter potentially liable under 16(b) as a result of a lockup agreement, I believe *Quintel* was a group of shareholders. It was a group of those three individuals I believe who privately held a corporation. And it was combining their shares and suggesting that they acted as a group. It is not the case and there still is no case that would support holding underwriters liable on this group theory as part of an IPO.

Thank you, your Honor.

THE COURT: Thank you, all. I'll reserve decision.

(Adjourned)